I

SUMMARY DESCRIPTION OF H.R. 1242
RELATING TO
STATE TAXATION OF INTERSTATE SALES

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON SELECT REVENUE MEASURES

of the

HOUSE WAYS AND MEANS COMMITTEE

on May 13, 1987

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

May 12, 1987

JCX-7-87

J862-20

H782-19

INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Ways and Means Committee has scheduled a public hearing on May 13, 1987, on H.R. 1242 (introduced by Mr. Dorgan).[1] The bill would eliminate certain restrictions on the powers of a State in taxing sales in interstate commerce.

This document,[2] prepared by the staff of the Joint Committee on Taxation, provides a summary description of present law, H.R. 1242 and a related bill (H.R. 1891),[3] and an overview of the issues raised by the bills.

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[1] H.R. 1242 ("Interstate Sales Tax Collection Act of 1987") was referred jointly to the Committees on the Judiciary and Ways and Means.

[2] This document may be cited as follows: Joint Committee on Taxation, Summary Description of H.R. 1242, Relating to State Taxation of Interstate Sales (JCX-7-87), May 12, 1987.

[3] H.R. 1891 ("Equity in Interstate Competition Act of 1987") (introduced by Mr. Brooks) was referred to the Committee on the Judiciary.

I. PRESENT LAW

Under the Constitution, a State or local government may impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction. (Approximately 6,700 State and local jurisdictions impose sales and use taxes.)[4] The allowable sales tax authority of a State or local government extends to mail order sales by out-of-State vendors to residents of the State if the sale is deemed to take place within the taxing jurisdiction.[5] There are, however, limitations on the methods State and local jurisdictions may employ to collect sales and use taxes.

State and local sales and use taxes are levied on the final purchaser, but are collected primarily through the vendor. In the case of a sale by an out-of-State vendor, the U.S. Supreme Court has held that the State or local government cannot constitutionally require the vendor to collect and remit use taxes unless the vendor has a sufficient business nexus with the State.[6] In the National Bellas Hess case, the Court found that the required nexus was not present where the vendor's only connection with customers in the State was by common carriers or the United States mail.[7] The Court based this conclusion on due process considerations and on the Commerce Clause of the United States Constitution, which reserves to Congress the power to regulate and control interstate commerce.[8] The required nexus has been held to exist where the vendor arranges sales through local agents or maintains retail stores in the taxing State.

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[4] Advisory Commission on Intergovernmental Relations, State and Local Taxation of Out-of-State Mail Order Sales (April 1986), p. 6.

[5] See, e.g., McLeod v. J.E. Dilworth Co., 322 U.S. 327 (1944).

[6] National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967) (henceforth referred to as National Bellas Hess).

[7] Id. at 753.

[8] Id. at 760.

II. DESCRIPTION OF PROPOSED LEGISLATION

H.R. 1242--Mr. Dorgan

Under H.R. 1242, any State (as well as the District of Columbia) or political subdivision of a State could require retailers engaged in business in that State to collect sales or use tax on the sale of tangible personal property, or on the use in such State or subdivision, of tangible personal property shipped or delivered to the purchaser in the State or political subdivision.

Retailers would be required to collect the tax if they met any of five general criteria demonstrating some business connection to the State. To reduce administrative burdens, retailers could be required by a State or political subdivision to collect sales and use tax only if (1) the retailer has annual nationwide gross sales of tangible personal property in excess of $5 million, (2) the combined rate of State and local tax on a given transaction is the same for all geographic areas within the State, and (3) any local tax is collected and administered by the State. Retailers required to collect these taxes under the bill would not be required to account geographically within a State for these taxes.

The bill also would require that retailers required to collect State sales or use taxes under the bill must provide certain information reports to the IRS as to their nationwide gross sales of tangible personal property and shipment or delivery of tangible personal property into each State. These information reports would be available to the States under present-law provisions relating to exchanges of tax information (Code sec. 6103(d)). The bill would be effective on enactment.

H.R. 1891--Mr. Brooks

A related bill is H.R. 1891 (introduced by Mr. Brooks). This bill would authorize any State (as well as the District of Columbia) to require retailers engaged in regular or systematic solicitation of sales in the State to collect State and local sales tax on the sale of tangible personal property with a destination in the State. To minimize the administrative burdens, retailers could be required by a State to collect State tax only if in the preceding year the retailer had gross sales of tangible personal property in excess of $12.5 million nationwide and $500,000 in the State. A retailer would also be required to collect local sales tax if the local sales tax on a given transaction is imposed at the same rate in all geographic areas within the State. Further, States could not require retailers to remit tax more frequently than four times per year. The bill would be effective on enactment.

III. OVERVIEW OF ISSUES

The purpose of each bill is to minimize the disparity that arises from the constitutional limitation on the power of a State or local government to require collection and remission of sales or use tax by an out-of-State vendor with no sales agents or retail stores in the State. Because State and local governments rely on vendors to collect and remit sales and use taxes on State residents, this constitutional limitation on the collection of these taxes generally has prevented the effective imposition of sales and use taxes on mail order sales by these out-of-State vendors. Accordingly, to the extent that purchasers can avoid sales or use tax liability by making mail order purchases from these out-of-State vendors, such vendors realize a competitive advantage in relation to in-State vendors (as well as in relation to out-of-State vendors with sales agents or retail stores in the State). Also, the bills might not completely eliminate the disparity between in-State and out-of-State vendors, in that the bills only relate to the taxation of tangible personal property. The scope of the sales and use taxes of a number of States is broader than that, extending for example to services and advertising.

Some argue that disparity between in-State and out-of-State vendors is undesirable for two reasons. First, they argue that equal tax treatment of in-State and out-of-State businesses is preferable to providing one type of business with a competitive advantage based solely upon the nonpayment of State taxes. Second, they assert that State and local governments should be assisted in collecting all revenues to which they are entitled, particularly to the extent that their tax bases are affected by out-of-State mail order sales.

Others argue that Federal legislation should not be adopted addressing this issue even if the above arguments generally express the proper policy. They rely principally on two concerns: constitutionality and the administrative burden on vendors.

The constitutional issue arises under National Bellas Hess, the Supreme Court case holding that a State could not require an out-of-State mail order vendor to collect and remit sales or use taxes with respect to its sales. Some observers note that the Supreme Court based its decision on the fact that interstate commerce "is a domain where Congress alone has the power of regulation and control." Thus, they conclude that Federal legislation authorizing State and local

governments to require collection and remission by out-of-State vendors of otherwise allowable sales or use taxes would remove the constitutional defect that the Supreme Court found. Other observers respond by arguing that National Bellas Hess requires a significant nexus between the out-of-State vendor and the taxing jurisdiction and that, on due process grounds, Congress may not be able constitutionally to dispense with this nexus requirement.

The issue of administrative burden relates to the fact that a mail order vendor, in order to comply with a requirement that it collect and remit sales and use taxes, presumably would have to be familiar with the tax laws in all jurisdictions with respect to which the requirement arose. In light of the multiplicity of sales and use tax rules applying in different political subdivisions of States, both bills seek to reduce this complexity by providing for the collection of local tax only if the rate of tax is equal for all geographic areas in the State.

In its 1986 Report,[9] the Advisory Commission on Intergovernmental Relations (ACIR) has recommended that Federal legislation be enacted generally similar in intent to both bills.

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[9] See Footnote 4, above.